Before the
Federal Communications Commission
Washington, D.C. 20554

In re Applications of

TELEPORT COMMUNICATIONS GROUP INC.,
Transferor,

AND

AT&T CORP.,
Transferee,

For Consent to Transfer of Control of Corporations Holding Point-to-Point Microwave Licenses and Authorizations to Provide International Facilities-Based and Resold Communications Services

CC Docket No. 98-24

MEMORANDUM OPINION AND ORDER

Adopted: July 21, 1998 **Released: July 23, 1998**

By the Commission: Commissioner Furchtgott-Roth concurring and issuing a statement.

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I. INTRODUCTION

1. In connection with a proposed merger between Teleport Communications Group Inc. (Teleport) and AT&T Corp. (AT&T), the merging parties have filed applications seeking authority, pursuant to Sections 214(a) and 310(d) of the Communications Act of 1934, as amended (Communications Act),[1] and Section 63.18 of the Commission's rules,[2] to transfer to AT&T control of Teleport's numerous communications licenses and authorizations.[3] In accordance with the terms of Sections 214(a) and 310(d), AT&T and Teleport (collectively, Applicants) must persuade us that their proposed merger will serve the public interest, convenience, and necessity before we can grant their applications.[4] In this case, the public interest analysis includes an analysis of the competitive effects of the transaction.

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[1] 47 U.S.C. §§ 214(a), 310(d) (1994).

[2] 47 C.F.R. § 63.18 (1997).

[3] Application for Authority to Transfer Control, filed Feb. 3, 1998 (*Application*), at 7; Application for Consent to Transfer of Control of ACC Network Corp., filed Feb. 3, 1998 (*ACC Application*); Application for Consent to Transfer of Control of BizTel, Inc., filed Feb. 3, 1998 (*BizTel Application*). These separate applications were consolidated into the instant CC Docket No. 98-24 for administrative convenience. *See* Teleport Communications Group, Inc. and AT&T Corp. Seek FCC Consent for Proposed Merger, *Public Notice*, DA 98-369 (CCB rel. Feb. 25, 1998).

[4] *See Applications of NYNEX Corp., Transferor, and Bell Atlantic Corp., Transferee, For Consent to Transfer Control of NYNEX Corp. and Its Subsidiaries,* 12 FCC Rcd 19985, 19987 at ¶ 2 (1997) (*Bell Atlantic/NYNEX Order*); *In the Matter of the Merger of MCI Communications Corp. and British Telecommunications PLC,* 12 FCC Rcd 15351, 15353 at ¶ 2 (1997) (*BT/MCI Order*).

2. Based on the record and our analysis of the effects of combining Teleport's current business assets and capabilities with AT&T's in the relevant markets, we conclude that the merger is unlikely to have any meaningful negative effects on competition. Moreover, our analysis indicates that the two companies' assets and capabilities are largely complementary, so the proposed combination will likely permit swifter entry into local exchange and exchange access markets than would otherwise occur. Furthermore, it does not appear that this accelerated entry will come at the expense of losing one of a very limited number of firms uniquely situated to foster competition in relevant markets. Accordingly, we find that the merger of AT&T with Teleport is in the public interest and approve the Application.

II. BACKGROUND

A. The Applicants

3. AT&T is the largest long distance and international carrier in the United States.[5] It provides communications services to residential, business, and government customers, and operates in more than 250 countries and territories around the world.[6] AT&T's revenues from communications services totaled $51.3 billion in 1997, of which $22.2 billion was derived from business long distance services and $24 billion from residential long distance services.[7]

4. In addition to the foregoing services, AT&T provides local exchange services to a relatively small number of customers. In particular, AT&T offers resold local exchange service to approximately 400,000 residential customers in eight states.[8] AT&T also offers a

[5] Federal Communications Commission, *Trends in Telephone Service* 24, 51 (Industry Analysis Div., CCB Feb. 1998) (*Trends in Telephone Service* (*Feb. 1998*)).

[6] *See* AT&T Corp., 1997 Annual Report 11 (1998) (*AT&T 1997 Annual Report*); AT&T Corp., 1996 Annual Report 1 (1997) (*AT&T 1996 Annual Report*). AT&T's domestic and international communications services include wireline long distance voice, data, and video services, wireless services, network management services, electronic commerce services, and online and internet access services. *AT&T 1997 Annual Report* at 25; *AT&T 1996 Annual Report* at 21.

[7] *AT&T 1997 Annual Report* at 28. As of December 1996, 100.2 million U.S. telephone lines (63.3 percent of the total 158.7 million presubscribed lines) were presubscribed to AT&T for long distance calls (including international). Federal Communications Commission, *Long Distance Market Shares: First Quarter 1998* at 5, 9 (Industry Analysis Div., CCB June 1998) (*Long Distance Market Shares* (*June 1998*)). FCC staff estimate that, in 1996, AT&T's share of presubscribed residential lines was 70 percent, while its share of business access lines was approximately 51 percent. Federal Communications Commission, *Long Distance Market Shares: Fourth Quarter 1997* at 19 (Industry Analysis Div., CCB Mar. 1998) (*Long Distance Market Shares* (*Mar. 1998*)).

[8] These eight states are Alaska, California, Connecticut, Georgia, Illinois, Michigan, New York, and Texas. Reply Comments of AT&T Corp. and Teleport Communications Group Inc., filed Apr. 27, 1998 (AT&T Reply Comments), at 13 & n.23. AT&T claims, however, that it has curtailed active marketing of these local residential services "because incumbent prices and operational issues have made these services uneconomic." AT&T Reply Comments at 13.

local calling service to business customers entitled "Advanced Digital Link."[9] This offering provides outbound local calling service in 49 states and outbound and inbound service in four states.[10] AT&T reports that its total 1997 revenues for local services were approximately $68 million.[11]

5. According to the Applicants, Teleport is the nation's largest competitive local exchange carrier (CLEC).[12] In 1997, Teleport earned revenues of $494.3 million.[13] It provides local exchange and exchange access services primarily to business customers located in urban areas and to a relatively small number of residents of multiple dwelling units in high-density markets.[14] Teleport's principal business customers include telecommunications-intensive businesses, such as healthcare and educational institutions, governmental agencies, long distance carriers and resellers, internet service providers, wireless communications companies, and financial services companies.[15] Teleport provides local service primarily through the use of its own local fiber optic facilities, broadband wireless capabilities, and rights-of-way, supplemented by resale of others' local services.[16] Teleport operates in 83 markets in the United States, including 29 of the largest 30.[17]

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9 *See* AT&T Reply Comments at 10 & n.14.

10 These four states are California, Connecticut, New Jersey, and New York. AT&T Reply Comments at 10 & n.14.

11 AT&T Reply Comments at 10 & n.14. *See* AT&T Corp., *AT&T Earnings Commentary* (*First Quarter 1998 Summary*) (Apr. 20, 1998).

12 Teleport Communications Group Inc., 1997 Annual Report 17 (1998) (*Teleport 1997 Annual Report*); *Application* at 7.

13 *Teleport 1997 Annual Report* at 20. These revenues included $252.4 million from dedicated services, $215.2 million from switched services, and $22.1 million from data and internet services. *Id.* Teleport's reported revenues were not segregated by business and residential sources.

14 *See Application* at 7-8.

15 *Teleport 1997 Annual Report* at 17.

16 *Application* at 8; Teleport Communications Group Inc., 1997 Annual 10-K Report 5 (1998) (*Teleport 1997 10-K*). As of December 1997, Teleport had more than 3,500 commercial and residential buildings connected directly to its network, and it served an additional 10,000 buildings. *Teleport 1997 Annual Report* at 15, 17. At that time, Teleport had approximately 280,000 access lines (7.5 million voice-grade equivalents), 150 local serving offices, 35 digital voice switches, and 491,000 miles of fiber spanning 9,500 route miles. *Id.* at 1, 4, 15, 17.

17 *Teleport 1997 Annual Report* at 5.

6. Teleport also provides long distance and international services, primarily through its subsidiary ACC Corp. (ACC).[18] In 1997, ACC earned worldwide revenues of $372.6 million,[19] of which $120.6 million were attributable to local, long distance and international calls billed in the United States.[20]

7. Through its subsidiaries, Teleport holds Section 214 authorizations to operate as an international facilities-based and/or resale carrier between the United States and all foreign points.[21] Teleport, through ACC, also holds licenses to operate six point-to-point microwave facilities in New York.[22] Through another subsidiary, BizTel, Inc. (BizTel), Teleport holds licenses to operate more than 213 38.6-40.0 GHz point-to-point microwave facilities throughout the country.[23]

B. The Merger Applications

8. On January 8, 1998, Applicants executed an Agreement and Plan of Merger ("Plan of Merger") that calls for the transfer of control of Teleport to AT&T.[24] Pursuant to the Plan of Merger, Teleport will become a wholly-owned subsidiary of AT&T in a stock-for-stock merger.[25] Applicants state that the proposed merger will result in a change in the ultimate

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[18] AT&T Reply Comments at 7-8 & n.7, 14-15; *Teleport 1997 Annual Report* at 5. Prior to its acquisition by Teleport in April 1998, ACC had been a provider of resold local, long distance, and international telecommunications services to businesses, residential customers, and educational institutions in the United States, the United Kingdom, Canada, and Germany. ACC Corp., *Proxy Statement/Prospectus for Special Meeting of Shareholders to be Held April 21, 1998* at 12-13 (Mar. 27, 1998) (*ACC Proxy Statement*). ACC operates a network of ten long distance (domestic and international) switches, six local exchange switches located in the United States, leased transmission lines, and indefeasible rights of use in international submarine cables. *Id.* at 13.

[19] *ACC Proxy Statement* at 109. These revenues included $327.5 million (88 percent) in toll revenue and $45.1 million (12 percent) in local exchange and other revenue. *Id.*

[20] *ACC Proxy Statement* at 111. ACC's U.S.-billed international revenue was $45.6 million in 1996 (the most recent year reported). Federal Communications Commission, *1996 Section 43.61 International Telecommunications Data,* (Industry Analysis Div., CCB Jan. 1998) (*43.61 Report*) at Figure 7 & Table D1.

[21] *See Application* at 1.

[22] *See ACC Application.*

[23] *See BizTel Application.* BizTel's microwave facilities are used to connect customers to Teleport's fiber-optic networks; to provide network redundancy, diverse routing, or quick temporary installations; and to provide stand-alone facilities where Teleport does not have fiber-optic networks. *See Teleport 1997 Annual Report* at 40. BizTel has applications pending before the Commission to acquire an additional 67 such licenses. *See BizTel Application* at 5.

[24] *Application at 3;* AT&T Corp., 1997 Annual 10-K Report 1 (1998) (*AT&T 1997 10-K*).

[25] *Application* at 3. More specifically, a newly-formed, wholly-owned Delaware subsidiary of AT&T will merge with and into Teleport. The surviving Delaware corporation will continue under the name Teleport Communications Group Inc., and its subsidiaries will become indirect wholly-owned subsidiaries of AT&T.

owners of Teleport, but will not involve any immediate change in the manner in which Teleport currently provides service to its customers.[26]

9. In connection with the Plan of Merger, Applicants filed with the Commission, on February 3, 1998, a joint application[27] requesting consent to the transfer of control to AT&T of various Section 214 authorizations held by Teleport or its subsidiaries.[28] On the same day, Teleport filed with the Commission two other applications requesting consent to the transfer of control to AT&T of licenses (or applications for licenses) held by Teleport subsidiaries, ACC and BizTel.[29] On February 18, 1998, Applicants, pursuant to the Hart-Scott-Rodino Antitrust Improvements Act of 1976,[30] filed a premerger notification with the Department of Justice. The Department of Justice completed its review without taking action against the proposed merger.[31] In addition, Applicants sought approval for the merger from 24 state public utility commissions, 23 of which already have granted the necessary approvals.[32]

Application at 3. *See also ACC Application*, Question 7, Exhibit 2; *BizTel Application*, Question 7, Exhibit 2. The Teleport subsidiaries will retain their existing names, and the Section 214 authorizations and licenses currently held by Teleport subsidiaries will continue to be held by those entities. *See ACC Application* (Cover Letter); *BizTel Application* (Cover Letter).

[26] *Application* at 3.

[27] *See Application* at 1-3.

[28] These authorizations include: (1) TC Systems, Inc.'s authority to provide international switched resale services (*see* Overseas Common Carrier Section 214 Application Actions Taken, *Public Notice*, Report No. I-8151 (rel. March 7, 1996) (File No. I-T-C-96-002)); (2) Eastern TeleLogic Corporation's authority to provide international resale services, *see Eastern Telelogic Corp., Memorandum Opinion, Order, and Authorization*, 12 FCC Rcd 809 (1997) (File No. I-T-C-96-654(TC)); (3) TCG America, Inc.'s authority to provide international facilities-based and resale services in accordance with Section 63.18 of the Commission's rules (*see* Overseas Common Carrier Section 214 Applications Taken, *Public Notice*, 13 FCC Rcd 8035 (1997) (File No. I-T-C-97-506)); and (4) ACC's numerous Section 214 authorizations (*see ACC Corp. Application for Authority, Pursuant to Section 214 of the Communications Act, to Transfer Control of an Authorized International Carrier, Memorandum, Opinion, Order, and Authorization*, 13 FCC Rcd 2981 (1998) (File No. ITC-98-010-TC) (granting Teleport consent to acquire ACC)).

[29] *See ACC Application; BizTel Application.* These licenses include: (1) ACC's six point-to-point microwave licenses in New York (*ACC Application*); (2) BizTel's 213 38.6-40.0 GHz point-to-point microwave licenses throughout the United States (*BizTel Application*); and (3) BizTel's 67 applications to provide 38.6-40.0 GHz point-to-point microwave service in areas throughout the United States. *Id.*

[30] 15 U.S.C. § 18 (1994).

[31] *See* AT&T Reply Comments at 2.

[32] AT&T Reply Comments at 2. An application is pending with the District of Columbia. States approving the merger include: Arizona, California, Colorado, Delaware, Florida, Georgia, Indiana, Kansas, Louisiana, Minnesota, Mississippi, Nebraska, Nevada, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Utah, Vermont, Virginia, West Virginia, Wyoming. Although a few of these states approved the merger subject to certain conditions regarding intrastate services, none of the states found that the merged entity would likely possess market power or impair competition in any relevant market. In fact, Mississippi and Utah

10. Several parties filed timely comments opposing the applications or petitions to deny or dismiss those applications.[33] These parties argue primarily that the applications are incomplete and/or that the proposed transfers of control would not be in the public interest because they would impair competition in the provision of telecommunications services.[34]

C. Legal Standards

11. Pursuant to Sections 214(a) and 310(d) of the Communications Act, the Commission must determine whether Applicants have demonstrated that granting a transfer of control of licenses and authorizations currently held by Teleport and its subsidiaries to AT&T would serve the public interest, convenience and necessity.[35] The public interest standard of Sections 214(a) and 310(d) is a flexible one that encompasses the "broad aims of the Communications Act."[36] These broad aims include, among other things, the implementation of Congress' "pro-competitive, de-regulatory national policy framework" for

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concluded that the proposed merger will actually promote competition among providers of local and interexchange telecommunications services. *See* Mississippi Public Service Commission, Order, Docket No. 98-UA-63 at 5 (Mar. 25, 1998); Public Service Commission of Utah, Report and Order, Docket No. 98-087-01 at 4 (Feb. 23, 1998).

[33] Keith Maydak filed Comments on February 25, 1998, a Petition to Deny on March 24, 1998, and Reply Comments on April 21, 1998. BellSouth Corporation (BellSouth) filed a Motion to Dismiss the applications on March 18, 1998 and a Petition for Approval With Conditions to Protect the Public Interest on March 31, 1998. Inner City Press/Community on the Move and Inner City Public Interest Law Project (Inner City) filed a Petition to Deny on March 26, 1998. Sprint Communications Company L.P. (Sprint) filed a Petition for Investigation and Other Relief on April 1, 1998. JMJ Associates, Inc. filed Comments on April 1, 1998. AT&T and Teleport filed an Opposition to BellSouth's Motion to Dismiss on April 1, 1998. Applicants, Ameritech Corporation (Ameritech), and the Greenlining Institute and Latino Issues Forum (GILIF) filed Reply Comments on April 27, 1998.

[34] In a public notice dated February 25, 1998, the Common Carrier Bureau designated this proceeding a "permit-but-disclose" proceeding because it involves "broad issues of public policy." Teleport Communications Group, Inc. and AT&T Corp. Seek FCC Consent for Proposed Merger, *Public Notice,* DA 98-369 (CCB rel. Feb. 25, 1998). Ex parte presentations were made to Commission staff by AT&T and Teleport on April 17, 1998 and May 18, 1998. In addition, AT&T filed ex parte documents in this proceeding on May 6, May 19, May 22, June 5, June 10 and June 16, 1998.

[35] 47 U.S.C. §§ 214(a), 303(r), 310(d) (1994). *See Bell Atlantic/NYNEX Order,* 12 FCC Rcd at 20000, ¶ 29; *BT/MCI Order,* 12 FCC Rcd at 15364, ¶ 28. The Commission also has jurisdiction under Sections 7 and 11 of the Clayton Act to disapprove acquisitions of "common carriers engaged in wire or radio communications or radio transmissions of energy" where "in any line of commerce . . . the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." *See* 15 U.S.C. § 18 (1994); 15 U.S.C. § 21(a). Both AT&T and Teleport are common carriers. Because our public interest authority under the Communications Act is sufficient to address the competitive issues raised by the proposed merger, we decline to exercise our Clayton Act authority in this case. *See, e.g., Bell Atlantic/NYNEX Order,* 12 FCC Rcd at 20005, ¶ 33; *BT/MCI Order,* 12 FCC Rcd at 15364, ¶ 28; *see also United States v. FCC,* 652 F.2d 72, 88 (D.C. Cir. 1980) (en banc).

[36] *Bell Atlantic/NYNEX Order,* 12 FCC Rcd at 19987, ¶ 2 & n.2 (and cases cited therein); *BT/MCI Order,* 12 FCC Rcd at 15353, ¶ 3.

telecommunications,[37] promotion of the competition policies of the Sherman and Clayton Acts,[38] and enhancing "[a]ccess to advanced telecommunications and information services . . . in all regions of the Nation."[39] The public interest analysis may also include an assessment of whether the merger will affect the quality of telecommunications services provided to consumers or will result in the provision of new or additional services to consumers.[40] In evaluating whether the proposed transaction furthers the aims of the Communications Act, the Commission may consider the trends within, and needs of, the telecommunications industry, the factors that influenced Congress to enact specific provisions of the Communications Act, and the nature, complexity, and rapidity of change in the telecommunications industry.[41]

12. The Commission's analysis of the competitive effects of the proposed transaction is informed by antitrust principles,[42] but it is not governed by the scope of the antitrust laws.[43] The applicants must demonstrate, *inter alia,* not merely that the merger will not "substantially . . . lessen competition . . . [or] . . . tend to create a monopoly,"[44] but that the "public interest, convenience, and necessity would be served by the [merger]."[45] The Telecommunications Act of 1996[46] sets a clear national policy that competition leading to

[37] *Bell Atlantic/NYNEX Order,* 12 FCC Rcd at 19987, ¶ 2; *BT/MCI Order,* 12 FCC Rcd at 15353, ¶ 3.

[38] 15 U.S.C. §§ 1-7 (1994); 15 U.S.C. §§ 18 *et seq.* (1994). *See Bell Atlantic/NYNEX Order,* 12 FCC Rcd at 19987, ¶ 2; *BT/MCI Order,* 12 FCC Rcd at 15354, ¶ 3 & n.6.

[39] 47 U.S.C. § 254.

[40] *See, e.g., Bell Atlantic/NYNEX Order,* 12 FCC Rcd at 20063, ¶ 158; *BT/MCI Order,* 12 FCC Rcd at 15430, ¶ 205 (describing "lower prices, improved quality, enhanced service or new products" as examples of consumer benefits resulting from merger-specific efficiencies that are relevant to the public interest analysis). We note that this list of considerations is not exhaustive, and consideration of other factors may be appropriate in the future.

[41] *Bell Atlantic/NYNEX Order,* 12 FCC Rcd at 20003, ¶ 32; *BT/MCI Order,* 12 FCC Rcd at 15365, ¶ 29.

[42] *See FCC v. RCA Communications, Inc.,* 346 U.S. 86, 94 (1953); *United States v. FCC,* 652 F.2d at 81-82.

[43] *See United States v. FCC,* 652 F.2d at 88; *see also Bell Atlantic/NYNEX Order,* 12 FCC Rcd at 20003-04, ¶ 32 & n.71 (distinguishing Commission's public interest analysis from Clayton Act Section 7 analysis regarding whether a proposed transaction will "substantially lessen competition").

[44] 15 U.S.C. § 18 (1994).

[45] 47 U.S.C. § 309(a). With respect to Section 214(a), the Commission must find that the "present or future public convenience and necessity require or will require" operation of the acquired wired telecommunications line, and that the discontinuation of the operation by the transferee is required by public convenience and necessity.

[46] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified at 47 U.S.C. §§ 151 *et. seq.*) (1996 Act).

deregulation, rather than continued regulation of dominant firms, shall be the preferred means for protecting consumers. Mergers that increase market power or retard the decline of market power conflict with this policy by impeding the advent of competition and thereby maintaining, rather than decreasing, the need for continued regulation.[47] In assessing mergers, we also consider whether any public interest benefits may result from the merger.[48] Ultimately, we must determine whether the applicants have demonstrated that the proposed transaction, on balance, serves the public interest.[49]

III. ANALYSIS UNDER PUBLIC INTEREST STANDARD

A. Analytical Framework for Assessing Competitive Effects

13. In our public interest analysis of the record in this proceeding, we begin by evaluating the current state of competition in the relevant markets, and the likely competitive effects of the proposed merger.[50] In conducting this evaluation, we consider the likely effects of the proposed merger on competition both during implementation of the 1996 Act and as the 1996 Act's implementation alters market structure in the future.[51] We also consider the likely effects of this proposed merger on international competition both now and as the liberalization commitments of the World Trade Organization's Basic Telecommunications Agreement (WTO Basic Telecom Agreement) take effect.[52] We assess whether the proposed merger would impede competition in the relevant markets.[53]

14. In conducting our public interest analysis of the competitive effects of the proposed merger, we generally follow the analytical framework adopted by the Commission in the *Bell Atlantic/NYNEX Order* and the *BT/MCI Order*.[54] As the Commission noted in the *BT/MCI Order*, this analytical framework is based not only on prior Commission analyses of

[47] *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20035, ¶ 95.

[48] *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20063, ¶ 158; BT/MCI Order, 12 FCC Rcd at 15367, ¶ 33.

[49] *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20001, 20007, ¶¶ 29, 36; *BT/MCI Order*, 12 FCC Rcd at 15367, ¶ 33.

[50] *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20008, ¶ 37; *BT/MCI Order*, 12 FCC Rcd at 15367, ¶ 33.

[51] *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 19989, ¶ 7; *BT/MCI Order*, 12 FCC Rcd at 15369, ¶ 36.

[52] *See BT/MCI Order*, 12 FCC Rcd at 15354, ¶ 4. The WTO Basic Telecom Agreement was signed on Feb. 15, 1997. *Id.* at 15356, ¶7 & n.14. Sixty-nine countries signed this agreement, by which most of the world's major trading nations committed to move from monopoly provision of basic telecommunications services to open entry and pro-competitive regulation of these services.

[53] *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 19988, ¶ 3.

[54] *See Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20008, ¶ 37; *BT/MCI Order*, 12 FCC Rcd at 15367, ¶ 33.

market power,[55] but "is also embodied in the antitrust laws, including the Department of Justice and Federal Trade Commission *1992 Horizontal Merger Guidelines* and the April 8, 1997 revisions of those guidelines."[56]

15. As the Commission explained in *Bell Atlantic/NYNEX* and *BT/MCI*, the first step in analyzing a merger is to define the relevant product and geographic markets that may be affected by the merger.[57] In doing so, we may, where appropriate, distinguish between "end-user" markets, where a final product or service is sold to end-user customers, and "input" markets, where the product or service is sold to firms that use it as an input in producing other products or services.[58]

16. Once we have defined the relevant markets, we identify the market participants in order to understand the likely competitive effects of the transaction.[59] To do this, we must focus on both the current and likely future competitive significance of the firms that are included in the market, just as the Department of Justice and Federal Trade Commission focus on likely future competitive significance when those agencies identify market participants and assign market shares for the purpose of assessing likely competitive effects.[60]

17. When faced with a proposed merger that affects markets that are themselves in a process of rapid change, the best way to analyze the likely effect of the merger is to isolate

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55 *See, e.g., Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, 12 FCC Rcd 15756 (1997) (*LEC Regulatory Treatment Order*); *Pacific Telesis Group, Transferor, and SBC Communications, Inc., Transferee, Memorandum Opinion and Order*, 12 FCC Rcd 2624 (1997); *Motion of AT&T Corp. to be Declared Non-Dominant for International Service, Order*, 11 FCC Rcd 17963 (1996) (*AT&T International Non-Dominance Order*); *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, Order*, 11 FCC Rcd 3271 (1995) (*AT&T Domestic Non-Dominance Order*); *Craig O. McCaw, Transferor and AT&T Co., Transferee, Memorandum Opinion and Order*, 9 FCC Rcd 5836 (1994) (*AT&T/McCaw Order*), *Memorandum Opinion and Order on Reconsideration*, 10 FCC Rcd 11786 (1995), *aff'd sub nom. SBC Communications, Inc. v. FCC*, 56 F.3d 1484 (D.C. Cir. 1995).

56 *BT/MCI Order*, 12 FCC Rcd at 15368, ¶ 34. In that order, the Commission noted that the analytical framework we apply is closely related to the "actual potential competition" doctrine applied by lower courts in evaluating certain non-horizontal mergers. *Id.* at nn.57-58. *See* United States Dept. of Justice Antitrust Div., and Federal Trade Comm'n, *1992 Horizontal Merger Guidelines*, 57 Fed. Reg. 41552 (1992); United States Dept. of Justice and the Federal Trade Comm'n, *Revision to the Horizontal Merger Guidelines* (Apr. 8, 1997).

57 *See Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20008, ¶ 37; *BT/MCI Order*, 12 FCC Rcd at 15374, ¶ 47.

58 *BT/MCI Order*, 12 FCC Rcd at 15368, ¶ 35.

59 *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20008-09, ¶ 37.

60 *See 1992 Horizontal Merger Guidelines*, 57 Fed. Reg. at 41555-56 §§ 1.32, 1.41 & n.15 (including as participants those firms that are not currently producing or selling the relevant product, but that would likely respond to a "small but significant and nontransitory" price increase by supplying the product, and noting that "[w]here all firms have, on a forward-looking basis, an equal likelihood of securing sales, the Agency will assign firms equal shares").

the effect of the merger from all other factors affecting the development of the relevant markets over time. This is achieved by framing the analysis in a way that holds constant the effects of all changes in market conditions other than those directly caused by the merger.[61] To do this, we also identify as market participants those firms that have been effectively "precluded" from the market. These "precluded competitors" are firms that are most likely to enter but have until recently been prevented or deterred from participating in the market by barriers to entry the 1996 Act seeks to lower.[62] We then identify most significant participants based on an analysis of capabilities and incentives to compete effectively in the relevant market.[63]

18. Next, we must evaluate the likely competitive effects of the proposed merger in each of the relevant markets. In the instant case, this requires us to examine both the likely competitive effects due to the "horizontal" aspects of the merger and the likely competitive effects due to the "vertical" aspects of the merger. We must examine competitive effects due to the horizontal aspects of the merger because, as described below, AT&T and Teleport participate in some of the same product and geographic markets. We must examine competitive effects due to the vertical aspects of the merger because, as also described below, AT&T uses in its long distance operations a service provided by Teleport, *i.e.*, access to local exchange networks to originate or terminate long distance telephone calls.[64]

19. Finally, we must weigh any potential competitive harms of the merger against its likely benefits. We do so to determine whether, on balance, the proposed transaction would promote the public interest.[65]

[61] *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20036, ¶ 97.

[62] *Id.* at 20020, ¶ 60.

[63] *Id.* at 20019, ¶ 58.

[64] *See, e.g.*, Michael H. Riordan & Steven C. Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 Antitrust L. J. 513, 519 (1995) (*Evaluating Vertical Mergers*).

[65] *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 19987, ¶ 2. As the Commission has previously noted, in evaluating a proposed merger affecting local telecommunications markets, we necessarily must assess future market conditions, and, in doing so, we can and must rely on our specialized judgment and expertise to render informed predictions about future market conditions and participants. *See, e.g., FCC v. RCA Communications, Inc.*, 346 U.S. 86, 96-97 (1953); *Cellnet Communications, Inc. v. FCC*, No. 96-4022, 1998 WL 372319, at **10-12 (6th Cir. July 7, 1998) (and cases cited therein). *See also FCC v. WNCN Listeners Guild*, 450 U.S. 582, 594-95 (1981); *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20011, ¶ 41 & n.99; *BT/MCI Order*, 12 FCC Rcd at 20012, ¶ 42 & n.72.

B. Relevant Markets

1. Product Markets

20. The relevant services provided by both Teleport and AT&T are local exchange and exchange access services, domestic long distance services, and U.S. international telephone service.[66] The Commission has determined in prior proceedings that each of those services constitutes a distinct product market.[67] We reaffirm those determinations and adopt them for purposes of this proceeding, because we find no close demand substitutes for local exchange and exchange access services, domestic long distance services, and U.S. international services.[68] For purposes of this proceeding, therefore, we identify the following three relevant product markets: (1) local exchange and exchange access services; (2) domestic long distance services;[69] and (3) U.S. international telephone service.[70] We further find that, in this proceeding, it is reasonable to subdivide the local exchange and exchange access market into customer groups that demonstrate similar demand patterns.[71] For purposes of this proceeding, we identify two such groups: (1) residential and small business consumers of local exchange and exchange access services, which we refer to as the mass market; and (2) medium- and large-sized business/government consumers of local exchange and exchange access services, which we refer to as the larger business market.[72] We also identify, for purposes of analyzing potential competitive effects due to the vertical aspects of the merger, one relevant input product market, namely, exchange access service.[73]

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[66] See AT&T Reply Comments at 8, 10-13; *Application* at 1, 8. The only international service for which this proposed merger would create a "horizontal" combination is international telephone service, also referred to as international message telephone service or IMTS.

[67] *See Bell Atlantic/NYNEX Order,* 12 FCC Rcd at 20014-15, ¶¶ 50-51; *LEC Regulatory Treatment Order,* 12 FCC Rcd at 15762, 15787, ¶¶ 5, 54 & n.19 (1997); *BT/MCI Order,* 12 FCC Rcd at 15376, ¶ 52.

[68] Moreover, there is nothing in the record that questions or undermines the Commission's prior determinations in this regard.

[69] *See Bell Atlantic/NYNEX Order,* 12 FCC Rcd at 20015, ¶ 51.

[70] There is no evidence in this record that the Commission needs to assess potential competitive effects on other product markets.

[71] *See e.g., Bell Atlantic/NYNEX Order,* 12 FCC Rcd at 20016, ¶ 53. We note, however, that in other merger proceedings it may be appropriate to analyze the competitive effects of the merger on customer segments in other product markets.

[72] *See, e.g., BT/MCI Order,* 12 FCC Rcd at 15375, ¶ 50. We find nothing in the record that suggests a need to analyze medium-sized businesses as a separate customer group.

[73] The Communications Act defines exchange access as "the offering of access to telephone exchange services or facilities for the purpose of the origination or termination of telephone toll services." 47 U.S.C. § 153(16).

2. Geographic Markets

21. In the *Bell Atlantic/NYNEX Order* and the *BT/MCI Order*, the Commission determined that, for purposes of merger analysis, it may aggregate into a relevant *geographic* market those customers in the same geographic area that face similar competitive choices regarding a particular relevant product or service.[74] With respect to local exchange and exchange access services, we recognize that discrete local areas may constitute separate relevant geographic markets, since customers in different local areas may well face different competitive alternatives. In this case, however, we conclude that we need not evaluate each discrete local area where Teleport is providing services, because we conclude that the merger is unlikely to have anticompetitive effects in the local market where Teleport has the greatest market share.[75] Moreover, carriers in local markets generally face similar competitive conditions. For example, virtually all local markets are dominated by the incumbent local exchange carrier (LEC).

22. With respect to domestic long distance services, the Commission has previously stated that, in general, it would treat long distance services as a single national geographic market.[76] We find nothing in the record in this proceeding to cause us to deviate from this approach in analyzing the likely competitive effects of the instant merger on the market for domestic long distance services. Accordingly, for purposes of this proceeding, we will adopt a national market as the relevant geographic market for domestic long distance services. With respect to U.S. international telephone service, the Commission seeks to determine whether the proposed merger will have anticompetitive effects on any U.S. international route.[77]

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[74] *Bell Atlantic/NYNEX Order,* 12 FCC Rcd at 20016, ¶ 54; *BT/MCI Order,* 12 FCC Rcd at 15375, ¶ 51. In the *Bell Atlantic/NYNEX Order*, for example, the Commission explained that it would treat as a separate relevant geographic market "an area in which all customers in that area will likely face the same competitive alternatives for a [relevant] product." *Id.*

[75] *See infra* Section III.D.2.

[76] *LEC Regulatory Treatment Order,* 12 FCC Rcd at 15792-95, ¶¶ 64-69. The Commission's decision to treat long distance services as a single national market was based upon its conclusion that geographic rate averaging, price regulation of exchange access services, and excess capacity in long distance transport caused carriers to behave similarly in each domestic point-to-point market. *See id.* at 15794, ¶ 66. The Commission clarified that it would treat long distance calling as a single national market unless there is credible evidence indicating that there is or could be a lack of competition in a particular point-to-point market, and there is a showing that rate averaging will not sufficiently mitigate the exercise of market power. *See id.*

[77] *See, e.g., LEC Regulatory Treatment Order*, 12 FCC Rcd at 15800, ¶ 79; *BT/MCI Order,* 12 FCC Rcd at 15376-77, ¶ 54.

C. Market Participants

23. The second step in our competitive analysis is to identify actual and, where applicable, precluded participants in each relevant market.[78] From the universe of such participants, we seek to identify, where appropriate, those that appear to be the most significant, based upon an analysis of both their capabilities and their incentives to compete effectively in the relevant market.[79]

1. Local Exchange and Exchange Access Market

a. Participants in the Provision of Local Exchange and Exchange Access Service to Residential and Small Business Customers

24. Although competitors have entered a few discrete local areas, incumbent LECs are the sole actual providers of local exchange and exchange access services to the vast majority of residential and small business customers in most areas of the United States.[80] Thus, incumbent LECs remain the most significant actual providers of local exchange and exchange access services to residential and small business customers.[81]

25. As for other significant market participants, the Commission, in the *Bell Atlantic/NYNEX Order*, found that AT&T, MCI, and Sprint were previously precluded competitors that were among the most significant potential participants in the market for local exchange and exchange access services provided to residential and small business customers, because each had "the capabilities and incentives to acquire a critical mass of customers in the

[78] *See Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20019, ¶ 58; *BT/MCI Order*, 12 FCC Rcd at 15379, ¶ 61.

[79] *See Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20020, ¶ 62 (focusing on market participants "that have, or are likely to speedily gain, the greatest capabilities and incentives to compete most effectively and soonest in the relevant market"). Some of these capabilities are basic to the operation of a telephone company. They can be relatively technical, and concern access to the necessary facilities, "know how," and operational infrastructure such as sales, marketing, customer service, billing, and network management. *Id.* Other capabilities are less tangible. They include brand name recognition in the mass market; a reputation for providing high quality, reliable service; existing customer relationships; and the financial resources to obtain these intangible assets. *Id.*

[80] In 1996, incumbent LECs earned 98.6 percent of all the local exchange and exchange access revenues generated nationwide. *See Trends in Telephone Service* (*Feb. 1998*) at 32. The local competition that has developed has focused on larger business customers in large cities, not on residential or small business customers. *Id.* at 28; *see also Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20032-33, ¶¶ 87-88.

[81] In fact, the record in this proceeding contains no evidence suggesting the existence of any significant *actual* market participants other than the incumbent LECs in this market segment.

relevant markets and to do so relatively rapidly."[82] The Commission further found that facilities-based CLECs, such as Teleport, were not among the most significant market participants in this market, because they lacked the financial resources and brand name reputation necessary to enter the residential and small business market quickly.[83] Finally, the Commission found that Bell Atlantic, as an adjacent incumbent LEC, was among the most significant market participants in at least parts of NYNEX's territory.[84] We find that the record before us supports the same findings in this proceeding.

b. Participants in the Provision of Local Exchange and Exchange Access Services to Larger Business Customers

26. Incumbent LECs also continue to dominate the larger business market for local exchange and exchange access services. In this market, however, in contrast to the market for residential and small business customers, incumbent LECs are facing increasing competition from numerous new entrants, including Teleport, that are building facilities as they seek to provide services to larger business customers.[85] AT&T also has started offering local service for larger business customers through its Advanced Digital Link Service.[86]

27. Recent statistics support the conclusion that incumbent LECs are facing increasing competition from new entrants in the market for local exchange and exchange access services to larger business customers. In 1996, for example, there were approximately 109 CLECs, with total revenues of $949 million, that were providing local exchange and exchange access services.[87] CLEC revenues have been increasing rapidly, from 0.3 percent of total revenues in

[82] *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20029, ¶ 82.

[83] *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20032-33, ¶¶ 87-88.

[84] *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20025-29, ¶¶ 73-79. While we need make no specific findings here, we note that adjacent incumbent LECs may well be among the most significant market participants in many local areas.

[85] There is evidence indicating that it may be easier for new entrants, especially smaller facilities-based CLECs, to enter the larger business than the mass market. For example, the Commission has previously noted that (1) business customers are more often "served under individual contracts and marketed through direct sales [contacts]," (2) competitive access providers (CAPs) have limited access to capital relative to the BOCs and major interexchange carriers, and (3) CAPs have a limited brand name reputation among residential and small business customers. *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20016, 20033, ¶¶ 53, 88.

[86] AT&T Reply Comments at 13.

[87] *See Trends in Telephone Service (Feb. 1998)* at Table 9.1. The 109 CLECs reported here include legal entities identifying themselves in their annual TRS Fund Worksheet filings as CAPs/CLECs. The number of legal entities reporting in this category in any particular year is influenced by ownership structure. For example, in 1996, American Communications Systems, Inc. reported as 20 separate legal entities (e.g., American Communications Services of Albuquerque, Inc., American Communications Services of Maryland, Inc. . . .). A number of companies, including GST Telecom, Inc., ICG Communications, Inc., McLeodUSA Incorporated, and Teleport, reported as single legal entities, even though they may operate through multiple legal entities. A list of the legal entities that reported as CAPs/CLECs in 1996 appears in Federal Communications Commission, *Carrier*

the local exchange and exchange access market in 1994 (when the only CLECs were competitive providers of exchange access services, commonly referred to as competitive access providers or CAPs) to approximately 1.0 percent in 1996.[88] CLEC revenues grew by approximately 70 percent in 1996 and over 100 percent during 1997.[89] Moreover, during this period, CLECs tripled fiber deployment from 0.4 million fiber miles at the end of 1994 to 1.3 million fiber miles (or approximately 10 percent of the 12.3 million fiber miles of incumbent LECs) at the end of 1996.[90] In addition, between 1995 and 1997, the number of competitors with collocation arrangements in incumbent LEC central offices nearly doubled from 58 to 106, and the number of central offices with such arrangements increased from 176 to 611 (347 percent).[91] Applicants state that, in each of Teleport's top ten markets, Teleport faces competition from five to twelve other operating CLECs, including Intermedia Communications, Inc., Metromedia Fiber Networks, Time Warner Communications, NEXTLINK, WorldCom, Inc., and e.spire.[92] We find that, although incumbent LECs continue to dominate the local exchange and exchange access larger business market, numerous new entrants are rapidly entering this market, especially in central business districts in urban areas, and that any number of these other new entrants have both the capabilities and the incentives to compete effectively and will be "at least as significant a competitive force as either of the merging parties."[93]

Locator: Interstate Service Providers (Industry Analysis Div., CCB Nov. 1997).

88 *Trends in Telephone Service* (*Feb. 1998*) at Table 9.1.

89 AT&T June 5, 1998 *ex parte* (attaching New Paradigm Resources Group, Inc., *1998 CLEC Report: Annual Report on Local Telecommunications Competition,* (9th ed. Mar. 1998) (*New Paradigm Report*) (Executive Summary) at 2).

90 *Trends in Telephone Service* (*Feb. 1998*) at Chart 9.1. Interconnected CLECs appear to have gained at least 40 percent of the high capacity special access market in the New York City central offices in which they are located, including 10 of 11 central offices below 59th Street in Manhattan. *See New York Telephone Company and New England Telephone and Telegraph Company, Nonrecurring Charges for Reconfiguration of Circuits,* 13 FCC Rcd 8324, 8336 (1998). Similar claims have been made concerning Boston, where Teleport operates a fiber ring. *See* NYNEX Files Petition to Extend USPP Waiver to Eastern Massachusetts LATA 128, *Public Notice*, 11 FCC Rcd 8655 (1996).

91 *Trends in Telephone Service* (*Feb. 1998*) at Table 9.2.

92 AT&T June 10, 1998 *ex parte.*

93 *See Bell Atlantic/NYNEX Order,* 12 FCC Rcd at 20019, ¶ 58.

2. Participants in the Provision of Domestic Long Distance Services

28. Hundreds of firms compete in the market for domestic long distance services, which in 1997 generated revenues of approximately $88.6 billion.[94] While AT&T remains the largest competitor in this market, its market share, measured by various means, has been steadily eroding since 1984.[95] In addition to the four interexchange carriers (AT&T, MCI, Sprint, and Worldcom) that currently possess coast-to-coast fiber-optic networks, at least four other carriers (Qwest Communications International, Inc., IXC Communications, Inc., Williams Communications Group, Inc., and Level 3 Communications, Inc.) are in the process of constructing coast-to-coast fiber networks.[96] Moreover, there are numerous regional facilities-based carriers and hundreds of carriers that provide long-distance services via resale or a combination of resale and owned facilities.[97] Finally, when the five regional Bell Operating Companies (BOCs)[98] meet the statutory requirements to enter this market in their regions, we expect them to be strong competitors. GTE and other non-BOC incumbents are actual participants in this market.[99]

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94 *Long Distance Market Shares (June 1998)* at 13. We note that these revenues include both interstate and intrastate toll revenues. *Id.* at 11. We need not undertake a "precluded competitor" analysis in connection with the long distance and international markets in this case because focusing on current market conditions presents a "worst case" scenario. The expected subsequent entry of precluded competitors into these markets will only tend to lessen any possible anticompetitive effects from the merger. *See Bell Atlantic/NYNEX Order,* 12 FCC Rcd at 20037, ¶ 99.

95 AT&T's share of long-distance carrier operating revenues has fallen from 90.1 percent in 1984 to 44.5 percent in 1997. *Long Distance Market Shares (June 1998)* at 16. AT&T's share of interstate switched access minutes fell from 80.2 percent at the end of 1984 to 51.4 percent at the end of 1997. *Id.* at 2-3. We note that the Commission reclassified AT&T as a non-dominant carrier in this market in 1995. *AT&T Domestic Non-Dominance Order*, 11 FCC Rcd at 3273 (finding that AT&T lacked market power in the interstate, domestic, interexchange market).

96 *See, e.g., IXC, Qwest Activate Coast-to-Coast Networks,* Telecommunications Reports (Apr. 20, 1998).

97 According to Commission data, there were 621 companies providing long distance service as of the end of 1996, the most recent year for which statistics are available. *See Trends in Telephone Service (Feb. 1998)* at 46. The combined revenue share of long distance carriers other than the four largest has grown from 2.6 percent in 1984 to 19.8 percent in 1997. *Long Distance Market Shares (June 1998)* at 16. *See also ACC Proxy Statement* at 95 (describing Excel Telecommunications, Inc., Frontier Corp., LCI International, and Cable and Wireless, Inc. as large regional long distance companies that constitute "second tier" of long distance industry). These four "second tier" companies each had long distance revenues exceeding $1 billion in 1997. *Long Distance Market Shares (June 1998)* at 11, 13.

98 The five regional BOCs -- Ameritech, Bell Atlantic, BellSouth, SBC Communications, and U S West -- are the successors to the local telephone companies that were owned by or affiliated with AT&T and included as defendants in the antitrust case that led to the Modified Final Judgment and divestiture of local telephone companies by AT&T.

99 *See Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Michigan,* 12 FCC Rcd 20543, 20552 & n.27 (1997) (noting that Southern New England Telecommunications Corporation's (SNET's) long distance affiliate captured 35 percent of SNET's local customers within two years of entry, and that GTE had reportedly converted one

29. Teleport is also a participant in this market, albeit a new entrant.[100] In 1997, Teleport's combined long distance revenues, including those of ACC, which it acquired in April 1998, totaled approximately $128 million, which represents approximately 0.14 percent of 1997 total long distance revenues.[101]

3. Participants in the Provision of U.S. International Telephone Service

30. There are also hundreds of carriers that compete with AT&T and Teleport in the market for U.S. international services, which in 1996 generated revenues of approximately $17.7 billion.[102] In 1996, there were 47 carriers providing U.S. international services by using their own facilities or lines leased from other carriers, with total market revenues of approximately $15.0 billion ($14.2 billion of which was attributable to telephone service).[103] About three hundred additional carriers provided U.S. international telephone service on a purely resale basis, with total market revenues of approximately $3.5 billion.[104] Additionally, the BOCs represent precluded competitors in this market, at least with respect to the provision of in-region international services.[105] GTE and other non-BOC incumbent LECs are actual participants in this market.[106]

31. With respect to the merging parties, AT&T's share of the international telephone service market, measured in terms of revenues, was 100 percent in 1984, but is now below 50 percent.[107] Teleport is also a participant in this market, but not a significant one.[108] The

million of its local customers into GTE long distance customers and was signing up customers at the rate of 6,000 per day in 1997). GTE has more than doubled the number of its long distance customers within the last year to 2.2 million. *See GTE Profits Flatten With New Data Investment, Competition,* Communications Daily (July 21, 1998).

[100] Teleport announced plans to enter the long distance market in September 1997. AT&T Reply Comments at 7.

[101] *Long Distance Market Shares (June 1998)* at 13.

[102] *43.61 Report* at Figure 7 & Table D1.

[103] *43.61 Report* at Figure 7.

[104] *43.61 Report* at Table D1.

[105] *See BT/MCI Order,* 12 FCC Rcd at 15383-84, ¶¶ 76-77. We also expect that foreign carriers will enter this market as a result of the market-opening commitments made by the United States in the WTO Basic Telecom Agreement.

[106] *43.61 Report* at Figure 6.

[107] *Trends in Telephone Service (Feb. 1998)* at 24. In 1996, market shares for the largest providers of international long distance telephone service to U.S. customers were as follows: AT&T, 48.3 percent ($8.6 billion); MCI, 20.3 percent ($3.6 billion); Sprint, 8.9 percent ($1.6 billion); Worldcom, 4.4 percent ($775

combined international telephone service revenues of Teleport and its subsidiary, ACC, was approximately $47 million in 1996.[109]

D. Analysis of Competitive Effects Due to "Horizontal" Aspects of the Merger

1. Overview

32. In this section, we assess the possible competitive effects due to the horizontal aspects of the proposed merger. As the Commission has explained in some detail in prior orders, a merger may have an anticompetitive effect due to its horizontal aspects if the merger enables the combined entity to achieve unilateral market power, or if it reduces the number of competitors in the relevant market so that the remaining firms can collectively exercise market power through coordinated interaction.[110] Alternatively, a merger may have a procompetitive effect if, as a result of the merger, the merged entity can more quickly or effectively challenge a dominant firm possessing unilateral market power in the relevant market, or if the merged entity becomes a stronger maverick that can prevent or limit coordinated interaction.[111]

2. Local Exchange and Exchange Access Services

a. Residential and Small Business Customers

33. We find that the merger of AT&T and Teleport is not likely to result in any increase in unilateral market power or increase the possibility of coordinated interaction in the provision of local exchange and exchange access services to residential and small business customers. As noted above, neither AT&T nor Teleport currently has more than a *de minimis*

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million); 18.1 percent ($3.2 billion) attributable to all others. *Long Distance Market Shares (June 1998)* at 26. These market share figures are based on combined revenues ($17.7 billion) for facilities-based and facilities-resale ($14.2 billion) and pure resale international telephone service ($3.5 billion). *See id.*; *Trends in Telephone Service* at 24-25. The Commission granted AT&T's request to be classified as a non-dominant carrier in this market in 1996. *See AT&T International Non-Dominance Order*, 12 FCC Rcd at 17964 (finding that AT&T no longer possessed market power in the U.S. international services market). AT&T's market share has continued to decline since AT&T was declared non-dominant.

[108] AT&T Reply Comments at 15; *43.61 Report* at Table D1.

[109] *43.61 Report* at Figure 7 & Table D1. This figure may overstate the amount of ACC's end-user IMTS revenues to the extent that ACC Long Distance Corp. resells ACC Global Corp.'s IMTS.

[110] *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20038, ¶¶ 101-02; *BT/MCI Order*, 12 FCC Rcd at 15397-98, ¶¶ 123-125. *See also 1992 Horizontal Merger Guidelines*, 57 Fed. Reg. at 41558-41560 §§ 2.1-2.2. Coordinated interaction consists of a group of firms' actions that are profitable for each firm only because of the accommodating reactions of the others. *See 1992 Horizontal Merger Guidelines* at 41558, § 2.1. A firm has unilateral market power if it can elevate price and suppress output on its own and remain profitable. *See id.* at 41559, § 2.2

[111] *BT/MCI Order*, 12 FCC Rcd 15397-98, ¶¶ 124-25.

market share in this market.[112] More importantly, the merger of Teleport into AT&T will not eliminate a "most significant" market participant in the relevant market. In the *Bell Atlantic/NYNEX Order*, the Commission found that, although AT&T was a most significant market participant in the mass market, CAPs generally, and Teleport specifically, were not among the most significant participants in this market.[113] There is nothing in the record of this proceeding to alter this conclusion.[114] We thus conclude that AT&T's acquisition of Teleport will not eliminate a most significant participant in the mass market for local exchange and exchange access services.

34. We find that, instead of having an anticompetitive effect, the merger, by combining the complementary assets and capabilities of the merging parties, is likely to have a procompetitive effect in producing a competitor that can more quickly provide consumers with an alternative choice for local service. By combining AT&T's strong brand name and substantial base of residential, long distance customers[115] with Teleport's substantial local facilities[116] and expertise and knowledge in providing local services, the merged entity should be better situated than either AT&T or Teleport individually to compete more quickly for residential customers in multiple dwelling units in high density markets in the short run,[117] and for broader groups of residential customers in the longer run.

[112] Teleport's market share for all local exchange and exchange access services was less than 0.5 percent nationally in 1997. This figure is based on Teleport's estimates that its local revenues were $494.3 million, while total local revenues were $104 billion. *Teleport 1997 10-K* at 3. AT&T states that, prior to suspending its local residential marketing efforts, it was only able to capture total local revenues of $68 million in 1997, which translates to a market share of 0.07 percent nationally. AT&T Reply Comments at 11, 13. Thus, AT&T's and Teleport's combined local revenues -- approximately $562 million -- were less than 0.6 percent of total local revenues in 1997. AT&T Reply Comments at 10. Because Teleport primarily serves larger business customers, its share of the mass market (and the combined entity's post-merger share), is far smaller than these figures suggest. *Teleport 1997 Annual Report* at 17.

[113] *See Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20024, 20032-33, ¶¶ 70, 87-88; *BT/MCI Order*, 12 FCC Rcd at 15399, ¶ 127.

[114] The record reflects, for example, that Teleport has not targeted this market. *See, e.g., Teleport 1997 10-K* at 3 (listing Teleport's major classes of customers without mentioning residential customers). Moreover, there is no record evidence that Teleport possesses any unique advantages that would make it among the most significant participants in this market.

[115] *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20030-20031, ¶¶ 82-84. The Commission's finding that AT&T had a strong brand name reputation among mass market telephone customers was based upon customer preference surveys. *See id.* at 20031, ¶ 84.

[116] *See Teleport 1997 10-K* at 2, 15 (noting that Teleport owns 35 local switches and has fiber SONET rings in as many as 83 cities).

[117] *Application* at 8. *See also* AT&T Reply Comments at 21-22 (stating that this group of residential customers "will be served immediately by the merged entity").

b. Larger Business Customers

35. We further conclude that the merger of Teleport and AT&T is not likely to result in any anticompetitive effects in the market segment for local exchange and exchange access services sold to larger business customers. Moreover, as we find in Section III.F. *infra,* we believe that a likely benefit of the merger is that the combined entity will be able to expand its local operations more quickly than either AT&T or Teleport could do so individually.

36. We find no evidence in the record suggesting that the merged entity will be able to exercise unilateral market power in the local larger business market segment, or that the merger would increase the likelihood of coordinated interaction. While we recognize the limited predictive value of current market share data in markets as dynamic as local telephone markets, we note that the combined entity's diminutive market share, immediately after the merger, clearly indicates that the entity will not possess unilateral market power. Although the record does not contain market share statistics for the individual markets at issue, Applicants' small market share in most markets is clearly demonstrated by the fact that, taken together, they accounted for only 0.8 percent of 1997 local revenue in larger business markets nationwide.[118] Teleport's pre-merger share of revenues in the New York metropolitan area, the market where Teleport has had the most success to date,[119] as a percent of total local revenues, was only about 3.5 percent in 1997, and the post-merger increase in market share will be insufficient to raise any competitive concerns.[120] Similarly, given the continued dominance of incumbent LECs in local markets, and the small but growing market shares of the many new entrants into local larger business markets, it appears most unlikely that the merger would facilitate any exercise of coordinated market power.[121] We thus conclude that the merger is not likely to confer unilateral market power on the combined entity or facilitate the exercise of coordinated market power.

37. We further conclude that the merger will not eliminate one among a limited number of most significant participants so as to impede the development of competition in providing local services to larger business customers. In this regard, as we noted above, local competition appears to be emerging most quickly in central business districts of major urban

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[118] Evidence in the record suggests that revenues from dedicated local services and switched local services attributable to business customers were approximately $68 billion in 1997, and that AT&T's and Teleport's local revenues amounted to approximately $562.3 million in that year, or approximately 0.8 percent. *See Teleport 1997 10-K* at 3; AT&T Reply Comments at 10. Thus, even if all of AT&T's and Teleport's revenues were derived from sales to business customers, their combined market share would be trivial.

[119] AT&T Reply Comments at 11-12; AT&T May 22, 1998 *ex parte.*

[120] Although the record does not indicate AT&T's market share of local larger business customers in metropolitan New York, an upper bound for total local revenues can be estimated by attributing all of AT&T's local revenues nationwide to the New York metropolitan area. Even under these unrealistic assumptions, the post-merger market share of the merged entity would be only 4.9 percent. *See* AT&T Reply Comments at 12.

[121] Among conditions discouraging collusion are a large competitive fringe; heterogenous, complex, and changing products; and a high ratio of fixed to total costs. *See, e.g.,* F.M. Sherer and David Ross, *Industrial Market Structure and Economic Performance* 315 (1990).

areas, where numerous new entrants are building or leasing facilities to compete for larger business customers.[122] Also, as noted, AT&T states, for example, that in each of Teleport's ten top markets, there are between five and twelve operational CLECs against which Teleport must compete.[123] In addition, by the end of 1996, CLECs had deployed more than 1.3 million fiber miles along more than 28,500 route miles, which represents approximately 10 percent of the incumbent LECs' total fiber deployment.[124]

38. We note, as well, that the larger business markets for local exchange and exchange access services differ significantly from the residential and small business markets for such services.[125] In the *Bell Atlantic/NYNEX Order,* the Commission concluded that, in addition to the incumbent NYNEX, there were only four most significant participants -- Bell Atlantic, AT&T, MCI and Sprint -- that could quickly and effectively enter the market for residential and small business customers in LATA 132.[126] This finding was based on the particular advantages that these companies had in entering the mass market, including strong brand name recognition, experience with mass market advertising, an established residential customer base, and substantial financial resources.[127]

39. In the market segment for local services to larger business customers, by contrast, we see many more firms entering successfully, and the capabilities and assets that the Commission cited in *Bell Atlantic/NYNEX* as prerequisites for successful entry in the mass market appear less essential to successful entry into the market for local services to larger business customers. Because larger business customers in general tend to be more sophisticated and knowledgeable purchasers of telecommunications services than residential or small business users, broad-based brand name recognition and mass advertising appear less important in attracting larger business customers. Moreover, although we found in the *Bell Atlantic/NYNEX Order* that CAPs' access to capital was limited relative to that of incumbent LECs or the major interexchange carriers and, thus, rendered them less significant participants

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[122] *See supra* Section III.C.1.b.

[123] *See* AT&T June 10, 1998 *ex parte*. *See also* Federal Communications Commission, *Fiber Deployment Update End of Year 1996* at 46-50 (Industry Analysis Div., CCB Aug. 1997) (*Fiber Deployment Update*). For example, AT&T reports that in New York City, Teleport's largest market, the following CLECs are currently operational: Focal Communications, Intermedia Communications, Inc., MCI Local Service, Metromedia Fiber Networks, MelTel, RCN Corporation, Time Warner Communications, USN Communications, Inc., WinStar Communications, Inc., and WorldCom, Inc. In addition, according to AT&T, the following CLECs are expected to be operational in New York within the next 12-18 months: Advance America Tel., Inc., Allegiance Telecom, Inc., Comav Telco Inc., e.spire, Eagle Communications, Inc., Local Fiber, L. L.C., NEXTLINK Communications, L.L.C., XCOM Technologies, Inc. AT&T June 10, 1998 *ex parte* (citing *New Paradigm Report*).

[124] *See Fiber Deployment Update* at 27, 39.

[125] *Bell Atlantic/NYNEX Order,* 12 FCC Rcd at 20024-35, ¶¶ 70-94.

[126] *Bell Atlantic/NYNEX Order,* 12 FCC Rcd at 20024, ¶ 70.

[127] *See Bell Atlantic/NYNEX Order,* 12 FCC Rcd at 20024-35, ¶¶ 70-94.

in the mass market, CAPs have been reasonably successful in attracting capital sufficient to begin entry into and expansion of their core larger business market segment.[128] As a result, unlike the residential market segment discussed in the *Bell Atlantic/NYNEX Order,* this market segment has a large number of market participants with similar incentives and capabilities. Thus, AT&T's acquisition of Teleport will not eliminate one among a limited number of most significant market participants, and the merger should not slow the development of competition in the provision of local services to larger business customers. We further find that, as described below, the merger is likely to enable the merged entity to more quickly mount a challenge to the dominant position currently held by incumbent LECs.[129]

3. Domestic Long Distance Services

40. We conclude that the proposed merger between Teleport and AT&T will not have any anticompetitive effects in the market for domestic long distance services. More specifically, we find that the merger will not give AT&T unilateral market power in this market. In 1995, the Commission reclassified AT&T as a nondominant interexchange carrier, based on its finding that AT&T lacked unilateral market power in the domestic interexchange market.[130] Since that time, AT&T's market share has continued to decline as new competitors have entered and as new fiber networks have been constructed.[131] Because the merger will increase AT&T's market share by an inconsequential 0.1 percent,[132] we find that we need not reconsider the conclusion in the *AT&T Domestic Non-Dominance Order*[133] that AT&T lacks unilateral market power in this market. Moreover, because we find that Teleport, operating on its own, would have a minimal competitive impact on the long distance market, the merger should not increase the likelihood of coordinated interaction among competitors. We also conclude, for these same reasons, that it is not necessary to separately assess the merger's

[128] *See Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20034-33, ¶¶ 87-88. Capital raised by CLECs in 1997 has been estimated at $7 billion. Goldman Sachs, *Telecom Services, CLECs 1998: Issues and Outlook* (Dec. 1997) at 8.

[129] *See infra* Section III.E.

[130] *AT&T Domestic Non-Dominance Order*, 11 FCC Rcd at 3273.

[131] AT&T's share of long-distance carrier operating revenues fell from 51.8 percent in 1995 to 44.5 percent in 1997, and its share of interstate switched access minutes fell from 55.5 percent to 51.4 percent during the same period. *Long Distance Market Shares* (*June 1998*) at 3, 16. We note, as well, that the Herfindahl-Hirschman Index (HHI) for the long distance market overall (based on long distance carrier revenues), has decreased considerably, from 3,197 in 1995 to 2,508 at the end of 1997. *Id.* at 16. Under Dept. of Justice guidelines, a market with an HHI of 2500 is considered "highly concentrated." *1992 Horizontal Merger Guidelines,* 57 Fed. Reg. at 41558, § 1.51.

[132] This figure is based on operating revenues of long distance carriers. *Long Distance Market Shares* (*June 1998*) at 13. The increase in the HHI will be 12.3 points. Mergers producing an increase in HHI of less than 50 points, even in highly concentrated markets post-merger, are unlikely to have adverse competitive consequences and ordinarily require no further analysis under Department of Justice and Federal Trade Commission guidelines. *1992 Horizontal Merger Guidelines,* 57 Fed. Reg. at 41558, ¶ 1.51(c).

[133] 11 FCC Rcd at 3273.

impact on specific consumer groups (*i.e.*, mass market and larger business customers) in this product market, as we have done with regard to local exchange and exchange access services.

4. U.S. International Telephone Service

41. We find that the proposed merger will not have any anticompetitive effects on any U.S. international telephone route. The evidence in the record indicates that it is unlikely that the merger will significantly increase concentration on any international route. The only market for which Teleport or ACC report facilities-based (or facilities-resale) U.S. international telephone service revenue is the U.S.-U.K. (United Kingdom) route, which is one of the five largest outbound routes in terms of minutes billed in the United States.[134] In 1996, ACC had reported U.S. billed IMTS revenue of $1.64 million on this route.[135] AT&T's reported revenue on this route in 1996 was $477.04 million out of a total $699.19 million (68.22 percent).[136] Thus, using 1996 figures, the combined entity would have revenues on this route of $478.68 million and a market share of 68.46 percent. This represents an increase in market share of only 0.24 percent.[137] We do not believe that this increase in concentration raises anticompetitive concerns, particularly in light of the expected increases in capacity on this route identified by the Commission in the *BT/MCI Order*.[138] ACC did not report any other facilities-based or facilities-resale income from any other route. We note that, as a pure resale carrier, ACC, together with Teleport, accounts for 0.25 percent of the total U.S. billed IMTS revenues in 1996.[139] We find that the resulting increase in concentration in the provision of IMTS does not raise anticompetitive concerns. We also conclude, for these reasons, that it is not necessary to separately assess the merger's impact on specific consumer groups in this particular product market.

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[134] *See 43.61 Report* at 70; *Trends in Telephone Service* (*Feb. 1998*) at 21, 23. Carriers are required to report international message telephone service (IMTS) revenues on a country-by-country basis for facilities-based and facilities-resale services. *Section 43.61 Data* at 3. Carriers are required to report only worldwide totals for pure resale services. *Id.*

[135] *43.61 Report* at 70.

[136] *43.61 Report* at Tables A1, E1. Market shares of other participants on this route are: (1) MCI/Western Union International, 15.7 percent; (2) Sprint, 9.9 percent; (3) WorldCom, 1.6 percent; and (4) all other carriers, 4.5 percent. *Id.* at Table E1.

[137] Staff analysis indicates that the increase in HHI as a result of the proposed merger would be only 32.8 points. As previously noted, mergers producing an increase in HHI of less than 50 points, even in highly concentrated markets post-merger, are unlikely to have adverse competitive consequences. *1992 Horizontal Merger Guidelines*, 57 Fed. Reg. at 41558, ¶ 1.51(c).

[138] *See BT/MCI Order*, 12 FCC Rcd at 15402, 15405-06 ¶¶ 134, 140-141 (stating that the Commission expects the transport capacity between the United States and the United Kingdom to increase significantly as a result of reductions in regulatory barriers to entry and in facilities costs).

[139] Comparing ACC Long Distance Corp. and Teleport combined 1996 pure resale revenues (approximately $45 million) with total IMTS revenues ($17.7 billion). *See supra* note 107 and *43.61 Report* at Table D1.

E. Analysis of Competitive Effects Due to "Vertical" Aspects of the Merger

42. Applicants contend that their proposed transaction is predominantly a "vertical" merger because Teleport supplies a service, exchange access, which is an input that AT&T uses in providing long distance services to end-user customers. In the *BT/MCI Order*, the Commission explained that, in evaluating mergers that result in increased vertical integration, it must examine whether the merger will increase the ability or incentives of the merged firm to affect competition adversely in any downstream end-user market.[140] The Commission went on to discuss a number of factors that might affect the incentives or ability of the merged firm to engage in strategies intended to raise rivals' costs.[141] Of particular relevance here, the Commission noted that a vertically integrated firm's incentive to engage in such strategies would be significantly reduced if rivals of the merged firm "had adequate alternative sources of supply" after the merger.[142]

43. In the instant case, the only allegation of an anticompetitive vertical effect of the merger, which is raised by Sprint, is that the merged entity may either raise the cost of exchange access services to its long-distance competitors or deny them such access altogether, which may harm competition in long-distance markets.[143] The essence of this line of argument appears to be that, for specific business customers, Teleport is the only alternative to incumbent LECs in providing exchange access and that, after the merger, the merged entity will have an incentive to raise access rates to nonaffiliated long distance carriers to the level set by the incumbent LEC, thereby giving AT&T an advantage in competing for the business customer.

44. We find that Sprint has failed to prove its argument. The evidence in the record suggests that there are competing providers of originating access in most markets in which Teleport is competing,[144] and that further entry appears likely. Since there are, or soon will be, other providers for originating exchange access services in these markets, it does not appear likely that Teleport could profitably raise prices to rival long distance companies since customers could switch to other access providers. Accordingly, we have no basis to conclude

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[140] *BT/MCI Order*, 12 FCC Rcd at 15410, ¶ 155. The Commission stated that consumers could be harmed by a merger that resulted in increased vertical integration if the vertical integration enabled the merged entity to engage in price or non-price discriminatory practices that resulted in consumers' paying higher prices for the same services or receiving lower quality services at the same price, or if it enabled the merged entity to execute a successful predatory price squeeze. *Id.*

[141] *BT/MCI Order*, 12 FCC Rcd at 15410-14, ¶¶ 156-62.

[142] *BT/MCI Order*, 12 FCC Rcd at 15414, ¶ 164.

[143] Sprint Petition for Investigation at 2-4. According to Sprint, the merged entity may have an incentive to forego profit maximization from the sale of access and price its exchange access service at the level of incumbent LECs in order to raise access costs to its rivals in the long distance market. *Id.* at 5.

[144] *See AT&T ex parte* in CC Docket No. 98-24 filed June 10, 1998 (indicating that there are between five and twelve operational CLECs in each of Teleport's ten top markets).